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Generational shift promises bigger pay perks for junior staff

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Before the crisis, swathes of junior investment banking staff moved into the buyout industry hoping to rise through the ranks to partner and make it rich on a share of the firm's profits. But the fact that many firms have started grooming junior executives to be their next generation of leaders has raised the prospect of big rewards coming sooner.

Weighing up staff: buyout firms are changing their traditional compensation models

Recruitment specialists say buyout firms are changing their traditional compensation models for junior staff in an effort to incentivise them to stay in the long term. This has coincided with the emergence of succession planning on the agendas of firms where members of senior management have left or are considering leaving the industry, believing its best returns to have come and gone.

An entry-level executive pay package traditionally comprises a base salary and an annual bonus that Gail McManus, founder and managing director of search firm Private Equity Recruitment, said could range from 10% of salary at small firms to 100% at large firms. According to Andrew Rubio, chief executive of outsourcing services provider Throgmorton, as they approach the middle echelons of a firm, staff start to receive a share of the profits – carried interest – at a proportion of 1% or less of the overall pool. McManus said staff usually had to have one to two years under their belts to qualify.

However, an investor relations executive at a UK buyout firm said mid-tier staff had begun to get better deals. This followed calls from investors, in the light of the tough fundraising environment, for private equity firms and their staff to commit more of their own capital to their funds and align their interests more closely with those of investors.

That, however, led to concerns that more junior staff could struggle to commit the necessary amounts. The investor relations executive said firms were increasingly allowing less senior staff to make smaller commitments and receive a disproportionate share of carry, thus incentivising them without asking them to commit too much.

According to recruiters, the shift to improve junior executives' incentives has come as industry-wide compensation for senior executives has remained largely the same since the crisis. McManus said: “Once you get to senior level, you do not have to attract people. It is about retaining people, but they are already retained because of other elements of compensation [carried interest] where they see the majority of their income coming.”

Earlier payouts

According to Simon Hamilton, head of fund finance at Investec Fund Finance, an arm of bank Investec, other changes to carried interest include the timing of carry allocation. Since 2009, firms have allocated about 60% of a fund's carry between reaching a first and final close, with the remainder allocated annually on the basis of individual performance. Traditionally, firms allocate all carried interest by the fund's final close. Hamilton said: “It is recognition of the work you have done in the last year.”

According to McManus, base salaries for entry-level positions, meanwhile, have risen from a range of £55,000 to £65,000 during the boom years to £65,000 to £85,000 today. She said this followed investment banks increasing salaries after a cut in bonuses.

McManus said that pay was going somewhere towards that of investment banks; and added: “You will not get the people otherwise. Generally, for the guys at that level from banks, it is a window of opportunity to enter and, once that window has gone, it is gone. You have to invest in private equity today and take less on the compensation or take the cash today and stay in banking.”

Meanwhile, according to McManus and Krista Parker, a director at search firm Parker Linton Associates, the number of firms paying bonuses is expected to rise this year, after many firms stopped bonuses during the crisis as the deal market dried up. McManus expected most firms to pay bonuses in the next 18 months, but the outlook remained uncertain, with the prospects of receiving a bonus stronger at firms able to raise new funds in a difficult market. However, she said bonuses would remain small.

Attractive sector

In contrast, Richard Thackray, regional managing partner of private equity in Europe, the Middle East and Africa at recruitment firm Heidrick & Struggles, said: “The reality is private equity remains an extremely attractive destination for bankers and it is a buyer's market [for buyout firms]. There are a vast number of people looking to be in the industry. [Firms] do not really need to pay people a lot more.”

Thackray also predicted a further shakeout as funds raised in 2007 come to the end of their investment periods and firms flood the market seeking more capital in a highly competitive environment.

McManus said: “There is definitely a dampening down of expectations on cash from private equity houses. People have to do the job and, if they are prepared to, they will invest in private equity for a couple of years to get the rewards later. If they do not understand that, they are not the right person for the job.”

So long, and thanks for all the bonuses

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